R4105-68 p (A)

The Conference Board

Economic and Business Environment Program

World Economic Monitor

Volume 3, Number 3 Summer 1988

U.S. SERVICES IN INTERNATIONAL TRADE

Services have come to dominate production in most industrial countries, accounting for at least half of total output in OECD member states. In 1987, nongovernment services accounted for almost 60 percent of U.S. gross national product and 57 percent of civilian employment. At the same time, both the types and value of services traded internationally have risen markedly, with total world services exports estimated at $400 billion annually.

Yet, despite the predominance of services in the U.S. economy, the contribution of trade in services to the U.S. international accounts is modest and likely to remain so:

- While U.S. exports of services have roughly doubled over the past ten years, they still amount to less than one quarter of merchandise exports.
- The *balance* on services trade is relatively small and hence does little to help offset the continuing large deficits on merchandise trade.
- Most international activity in services is linked closely to trade (shipping) and intellectual property (fees and royalties). In 1987, the "newer" kinds of internationally traded services, such as construction and consulting, accounted for less than one quarter of U.S. services exports.
- As in the case of goods, U.S. multinationals sell a considerably larger share of services through their foreign affiliates than through direct sales from the United States.

The Role of Services

The amounts generated by U.S. international trade in private business services (see box) are relatively small. Even though over the past ten years both exports and imports of services have more than doubled (Chart 1), in 1987 services exports and imports equaled only 23 percent and 14 percent of merchandise exports and imports, respectively. As a result, the surplus on services trade has also remained small, affording only a minute offset to continuing large deficits on merchandise trade (Chart 2).

Chart 1

Source: Department of Commerce

Despite the high portion of U.S. output represented by services, it is highly unlikely that trade in services will ever replace trade in goods as a major factor in U.S. international transactions. For one thing, the bulk of activity in business services is closely linked to trade and investment in general. Traditionally, within the business services category shipping and fees and royalties related to proprietary rights have, together with tourism, accounted for the bulk of transactions. Trade in such services must therefore be seen as complementary to merchandise trade and investment activity—and will likely move in the same direction and at the same pace.

Copyright © 1988 by The Conference Board, Inc.

WORLD ECONOMIC MONITOR (ISSN 0896-2545) is published quarterly by The Conference Board, Inc., 845 Third Avenue, New York, N.Y. 10022. Printed in New York, N.Y. Second-Class Postage at New York, N.Y. POSTMASTER: Send address changes to The Conference Board, 845 Third Avenue, New York, N.Y. 10022.

The "newer" or "emerging" services, such as construction, consulting, and communications, on which hopes for offsets to the trade deficit are generally pinned, account for only a small part of the total—about 22 percent of services exports in 1987 (Chart 3).

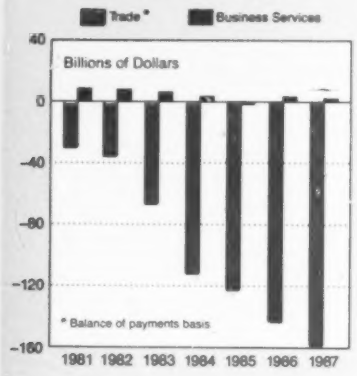
Measuring Services

There are several reasons why the statistics on trade in services are relatively low. Perhaps most important, international barriers to the transfer of the newer and less traditional business services remain formidable. There are also considerable problems in gathering the data.

A 1986 report by the Office of Technology Assessment (OTA) of the U.S. Congress found that the current system of reporting U.S. trade in services results in major errors that "arise in part from difficulties inherent in measuring production and trade in the services. Most services, as intangibles, cannot be stored, transported, or counted as they cross national borders." Moreover, "procedures for data collection and estimation have not kept pace with the growth in volume and diversity of international service activity."

Chart 2

Balances on Trade and Business Services



Source: Department of Commerce

Services: Some Definitions

The service account in the balance of payments has been described as "a composite of many dissimilar types of transactions." Yet, these have a common denominator since they involve selling part of the output of the United States or providing a return on U.S. capital invested abroad and foreign capital invested in this country.

The present discussion focuses exclusively on "private business services," that is, international transactions between private parties that are of a strictly business nature or incidental to other business transactions. Interest and dividend payments fall into another category. In detail, private business services include:

- Travel: Services provided to U.S. citizens traveling abroad and to foreigners traveling in the United States.
- Passenger transportation: Transportation provided to U.S. residents by foreign carriers and to foreign residents by U.S. carriers.
- Shipping: Services involving freight movements and use of port facilities.
- Proprietary rights (included in the balance of payments as "fees and royalties"): Payments for the use or sale of intellectual property rights, such as patents, processes, copyrights, trademarks, and franchises.
- Other business services: Construction, engineering, architecture, consulting, banking, brokerage, communications, insurance, advertising, accounting, legal, medical, and other services.

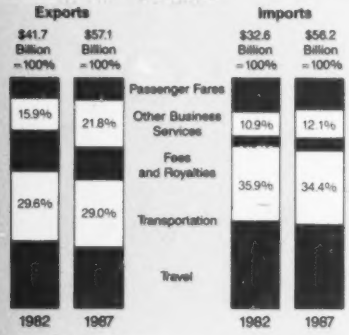
The OTA estimates that in 1984, for instance, exports of services—officially reported at $44 billion—may actually have been underreported by $25 to $47 billion. With service imports also underreported by an estimated $16 to $33 billion, the 1984 surplus on services would have come to about $14 billion versus an official report of $2.3 billion. While even the more realistic, much larger surplus calculated by the OTA pales when compared to 1984's $114 trade deficit, more accurate reporting of service transactions would put them in a better light with respect to the country's overall balance of payments.

Apart from purely statistical shortcomings, a major difficulty in getting a proper handle on the services trade is that their provision frequently is linked to that of goods and hence is not counted separately. As a Commerce Department analyst observes, "Services and goods are often inextricably bundled. The sale of a new computer by a U.S. company inevitably will involve design, consulting, installation, and software services, but the entire transaction will probably be recorded as merchandise trade rather than services trade." (He also remarked that interest and dividend payments—not included in this discussion—would be entirely recorded as investment income, even though a significant part of the payments might cover such supporting services as planning, bookkeeping and billing).

Chart 3

Composition of Business Services Trade

(In Percent)



Source: Department of Commerce.

Along the same lines, a study prepared for the National Planning Association notes: "Domestic firms producing raw materials, goods or services provide management, data processing, accounting and other services from the home office to their mines, plantations, factories and offices abroad and in a sense are competing with foreign suppliers. If these services were provided to unaffiliated enterprises, they would be counted as exports but . . . they may not appear as trade items in intracorporate accounting."

The close link between merchandise trade and related services sheds light on another aspect of why services exports are unlikely to take off in the years ahead. Sales by foreign affiliates of U.S. companies, particularly of large U.S. multinationals, generally exceed those companies' exports from the United States. Since many service functions have to be performed or delivered in conjunction with a specific product, sales of services by the foreign affiliates of U.S. companies are likewise many times larger than exports of such services from the United States (Chart 4). This, incidentally, lends further strength to the argument that on the basis of their *worldwide* sales U.S. companies do not appear to have lost ground in world markets.

Physical pressure in a market is even more necessary for professional services. As one respondent to a Conference Board survey comments: "Effective client relations are critical to the success of professional service firms in any market. They require physical proximity and intimate knowledge of the language, business practices, laws, and regulations of the country and a understanding of national aspirations."

Barriers to Services

Foreign barriers to the "newer" kinds of services provide another obstacle to their rapid expansion across national borders. Despite the increasing importance of services to the world economy—total world exports of services are estimated at $400 billion a year—these transactions are not yet covered by the rules of the of the General Agreement on Tariffs and Trade (GATT). After much lobbying by the United States and other countries with major service industries, the GATT decided to include the sector in its current ("Uruguay") round of negotiations, however.

Chart 4

Worldwide Sales of Business Services by U.S. Multinationals, 1984

* Nonbank majority-owned affiliates

Source: Department of Commerce

The negotiations on services trade will not take within the established GATT framework, but will be a separate exercise paralleling the negotiations on goods. The two parts will come together at the end of the negotiating round, currently expected at end-1990. One important reason for this special treatment is the strong opposition of some developing countries, especially Brazil and India. These countries argue that their fledgling service sectors would be at a disadvantage in the negotiating process, since the industrial countries might bar imports of their goods unless concessions on services were obtained.

National restrictions on foreign involvement in sensitive sectors, such as banking, insurance, communications and leasing, have always existed—but recently their importance has come to the fore as such activities gained prominence on the international scene. As the National Planning Association study notes, the United States certainly is not without regulations of its own, such as in banking, shipping, and the "Buy American" provisions of many states. But the extent to which in many foreign countries services are either government monopolies or government-controlled introduces an automatic bias against any outside competitor and "this unequal bargaining position is aggravated as the United States continues to deregulate its own service industries, to the advantage of foreign as well as domestic suppliers."

The Conference Board

845 Third Avenue, New York, N.Y. 10022 / 759-0900
1755 Massachusetts Avenue, N.W., Suite 312, Washington, D.C. 20036
255 Smyth Road, Ottawa, Ontario, K1H-8M7, Canada
Avenue Louise, 207-Bte 5; B-1050 Brussels, Belgium

Prepared by John Hein, Economic and Business Environment Program, Eric J. Kruger, Director. Reproduction permissible with full citation to The Conference Board as source. Published quarterly at 845 Third Avenue, New York, New York 10022.